INVESTMENT AMOUNT INCREASES FOR THE U.S. EB-5 VISA:

The Likely Economic Consequences in Today's Marketplace

SCOTT W. BARNHART, PHD
PRESIDENT, BARNHART ECONOMIC SERVICES, LLC, ASSOCIATE PROFESSOR OF FINANCE, FLORIDA ATLANTIC UNIVERSITY

Introduction: Recent proposals for increasing the minimum investment amount for the U.S. EB-5 visa from the current $500,000 and $1,000,000 amounts for TEA and non-TEA projects, respectively, have been the subject of much debate. Proposed legislation by Senators Grassley or Cornyn would raise the minimum investment amounts to $800,000 and $1,000,000, or $800,000 and $925,000, while the proposal from the Department of Homeland Security would raise them to $1,350,000 and $1,800,000. The proposals stem mainly from the perceived need to adjust the investment amount for inflation, as the current amounts have not been adjusted since the program's inception, some 28 years ago. It should also be noted that all of the proposals above impose such high hurdles to qualify for the lower TEA amount that in effect the higher investment amounts above seem as a practical matter more likely to become the market standard.

Some in the industry argue that raising the investment amounts will reduce the number of I-526 petition submissions but may increase the total capital coming to the U.S. due to the larger minimum amount and the inelasticity of demand for the EB-5 visa (see definition below). Thus, more EB-5 capital may result from fewer investors, thereby increasing the job buffer for projects (as long as job requirements don't increase) and reducing the administrative burden as fewer I-526 petitions are being processed. Others, particularly immigration agents from countries with emerging markets for EB-5, argue that substantial investment amount increases will eviscerate an already fragile (if not significantly declining) market for employment-based visas, where retrogression has severely reduced demand.

Addressing these issues, this article reviews the concepts of supply and demand and elasticity, i.e., the responsiveness of quantity demanded or supplied to a change in price. The article uses these concepts to analyze the past and current supply/demand conditions in the market for EB-5 visas, and the likely consequences of the proposed investment amount (price) increases. The discussion starts with the fact that the current EB-5 market is in a state where quantity demanded exceeds quantity supplied due to strong demand and a government enforced restricted supply that has resulted in an EB-5 cap that has been reached annually since 2014. The article then addresses the effects of retrogression (backlogs in visa availability), which has severely reduced (especially Chinese) demand for EB-5 visas, resulting in the possibility that in 2018 the market may experience an excess supply situation, and the potential effects of increasing the investment amounts to levels proposed above. Finally, it briefly discusses the effects of an alternative interpretation of the visa quota, wherein the 9,940 EB-5 visas available annually[1] would be allocable to investors alone, excluding accompanying family members.

A Basic Explanation of Supply and Demand and Elasticity

In most markets for goods and services in the

1 Describing the "annual quota" as 9,940 EB-5 visas assumes the statutorily prescribed maximum of 7.1% of the worldwide total of 140,000 employment-based immigrants annually; the actual number of visas available during any given year fluctuates based on visa usage in other classifications. Thus, it is also accurate to describe the annual EB-5 quota as approximating 10,000 visas.

Continued On Page 35

Continued From Page 34

U.S. and many other areas around the globe where competition exists, supply and demand are largely of the text book variety. That is, the supply schedule of the good is sloped upward to the right, implying more of a good is supplied by producers at higher prices, and the demand schedule is sloped downward to the right, implying less of a good is demanded at higher prices. In this situation, prices and quantities adjust to economic conditions to arrive at an equilibrium price where quantity demanded equals quantity supplied. Unlike textbook illustrations, however, most understand that the intersection of supply and demand is a range or area in the chart rather than any precise price and quantity.

The quantity demanded for a good or service is a movement along the curve, whereas a shift in the curve occurs as a result of a change in one of the determinants of demand, aside from price and quantity. The determinants of demand are the following, with the expected effect on demand denoted either positive (+) or negative (-). Demand is a function of its own price (-), consumer incomes (+), the prices of substitute goods (+), prices of complement goods (-), consumer tastes and preferences (+ or -), price expectations of the good at some future point (+), and population (+). Likewise, the supply of a typical good (not the EB-5 visa, as its supply is fixed by the U.S. government) depends on the price of the good supplied (+), the costs of production (-), the prices of related goods (+ or -), available technology used in production (+), price expectations (-), and production capacity of the good in the economy (+).

While the price of the good or service and consumer income are among the most important determinants of total demand, it is the price and availability of close substitutes that determines consumer responsiveness, i.e., quantity demanded, to changes in its price. This responsiveness in both demand and supply is known as the price elasticity of demand or supply and is defined as the percentage change in quantity supplied or demanded to a percentage change in price. Elasticity of demand, and similarly for supply, determines the steepness of the two curves, which in turn determines how large a response in quantity demanded or quantity supplied there is from a change in price. The fewer the number of close substitutes, the more of a necessity that the product is, such as energy or a life-saving medicine, the more inelastic its demand (see D1 in Figure 1), the steeper is its demand curve and the less responsive quantity demanded is to a change in price, implying price can increase a great deal and demand will not change much. When demand is inelastic, increases in price generally increase total revenue, represented by the box P x Q with a small loss in revenue from Q* to Q1 and a large gain in revenue from the movement from P1 to P2. On the other hand, for goods with highly elastic demand (D2), there is a large response in quantity demanded to changes in price from Q* to Q2 with corresponding large loss in revenue. The number of producers, available spare capacity, production time, available substitutes, etc., determine the elasticity of supply. For products with a small number of producers, small capacity, little time for production, etc., such as rare wines or flu vaccine in a given flu year, the supply response is very inelastic to price (S1) shown in Figure 2, while products with the opposite characteristics, i.e., responsive supply, are elastic (S2).

To fully understand the supply/demand characteristics in the EB-5 market, one needs to realize that this market is highly restrictive and not at all subject to competitive forces, especially on the supply side. The supply of visas is fixed by the U.S. government, and hence perfectly inelastic. Moreover, the demand for the visa is subject to an intense regulatory burden that must be paid for by the investor, but with uneven outcomes for similar expenses. The IIUSA data show that over the years 1992-2017 18.94% of all EB-5 adjudications resulted in denials, and more recently, 15.38% have been denied since 2013. While this regulatory burden raises the effective price of the visa, it also distorts this price because the expected value of getting one is now lower, i.e., an 80-85% chance of getting one, plus 15-20% chance of not getting one. The result of this supply/demand situation is that one can never know what the true current equilibrium price for the EB-5 visa is unless supply is allowed to vary freely. With unfettered supply and demand, the equilibrium price could be higher than or well below $500,000.

The Recent Past and Current Status of the

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FIGURE 1:

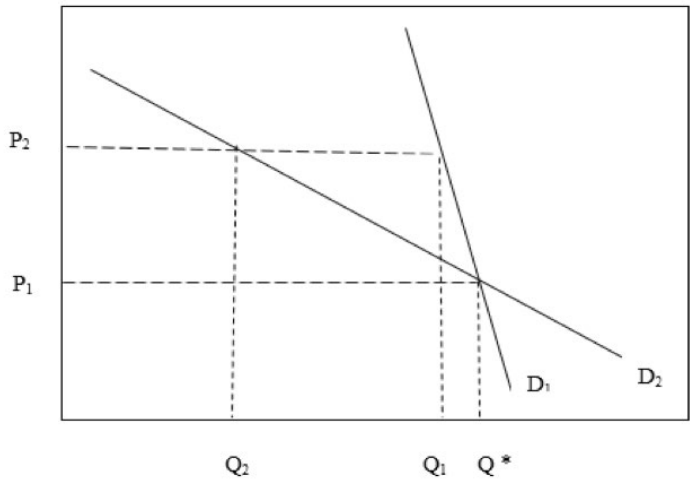


FIGURE 2:

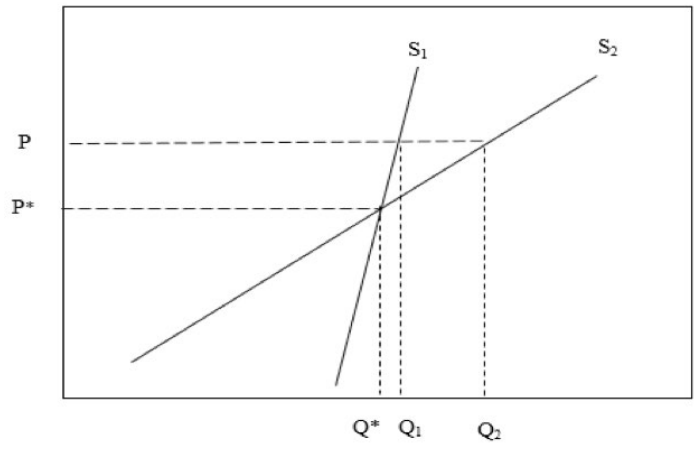


FIGURE 3: Total I-526 Receipts and Adjudications: Fiscal Year 1992-2017

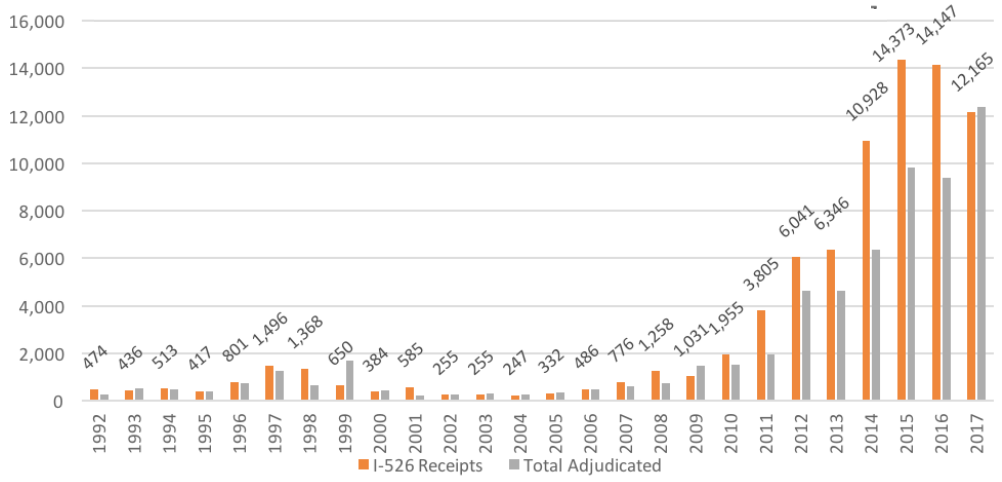
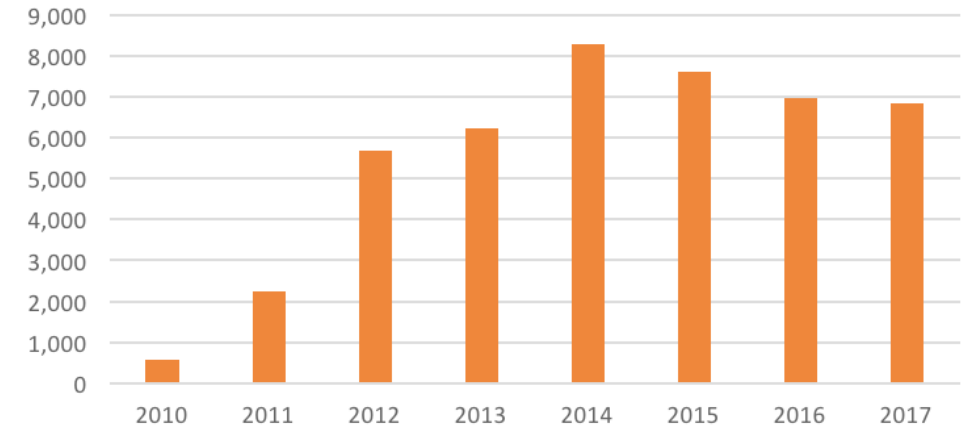


FIGURE 4: Total 5th Preference Visas Issues to Mainland China



Continued From Page 35

Supply/Demand Situation for the U.S. EB-5 Visa

Given the current state of the EB-5 visa backlog, many might think they already know the current supply/demand situation and perhaps the elasticities of supply and demand for the visa as well. I think most would agree that the supply of EB-5 visas is inelastic given that the number of visas is capped each year, Congress apparently has little desire nor means to "produce" more of them, and the U.S. Department of State seems unlikely to change the current interpretation of the applicable statute to count investors only (and not family members) against the annual quota. The elasticity of demand for the EB-5 visa is another matter, as there have been no adjustments to the investment amount since the program's inception, so it is unclear how responsive quantity demanded is to price changes. Some consider the EB-5 visa as a luxury good, defined as a good whose demand increases more in response to a percentage change in income relative to what occurs for normal goods. That said, luxury goods still are characterized as being more price elastic than price inelastic. Moreover, the EB-5 visa is not a necessity for life like the medicines described above. Finally, although there is no exact substitute for a U.S. visa, a number of other countries, such as Canada and Australia offer similar visas, and some Caribbean islands offer visas in exchange for purchases of real estate. In the absence of more knowledge, I conclude that the demand for the EB-5 visa is probably relatively inelastic, but not perfectly inelastic, which implies smaller changes in quantity demanded to a change in price than for elastic demand.

Although the visa backlog seems as if it has been present for a long time to industry participants, it is actually a relatively recent phenomenon. The backlog is a result of individual countries hitting their respective per-country limit of 7% of all worldwide visas (both family-based and employment-based). Data from IIUSA shown in Figure 3 charts the number of I-526 petitions received and adjudicated by USCIS from 1992-2017. Although these figures are indicative of visa demand, they are not the pertinent data that determine the backlog, these data are visas issued. That said, two items are worth noting: 1) Prior to 2014 demand was clearly not as large as it has been since; 2) There has been a noticeable decline in I-526 receipts since 2015, presumably due to a number of reasons including retrogression for Chinese investors, the higher cost of EB-5 capital, and availability of cheaper capital from other sources in the U.S. Figure 4 verifies this fact, illustrating that the total number of 5th preference visas issued to China mainland born residents, obtained from Annual Reports from the U.S. Department of State Visa Office, has declined since 2014. In addition, the Visa Bulletin indicates that in May of 2015 a cutoff date was issued for Mainland China residents, signaling the beginning of the current backlog.

Thus, the data indicate that in the years prior to 2015 no per country limit for Mainland China had been reached and no shortage of visas existed. Thus, the investment price prior to 2014 could in fact be considered too high, not too low, as shown by the demand curve for 2013 in Figure 5. This is an excess supply situation where if the investment amount was free to fluctuate it could have been well below the $500,000 amount shown in the Figure where the 2013 demand curve intersects the vertical supply curve. However, demand for the visa continued to be strong thereafter and the situation quickly reversed in 2014 and beyond through at least 2017. The result is a market that at least for this period was in a classic excess demand situation where the current $500,000 investment amount is too

Continued On Page 37

Continued From Page 36

low to clear the market. Thus, the clearing price in an unregulated market prior to 2013 would have been well below $500,000, while in more recent years it would be well above. It is this excess demand that some cite as the reason the investment amount should be raised. In Figure 5, the quantity demanded has exceeded the capped supply for a number of years now shown as a shift in demand to 2014-2017.

At the recent IIUSA conference of April 22-24, 2018 Charlie Oppenheim, Chief of the Visa Controls Office at the U.S. Department of State announced that wait times could be as long as 15 years for immigrants from China and 2-6 years for other countries. It is apparent to most in this industry that due to the excessively long wait times for Chinese investors, the demand for the EB-5 visa has declined dramatically from previous levels. The latest data through the end 2017 confirm this trend, and it not likely to change soon unless Congress changes the current law to allow more EB-5 visas, or to not count investor families, both of which seem unlikely in the short run. Therefore, we must assume that retrogression remains a fixture in the industry that is severely reducing Chinese demand. The situation is illustrated in Figure 6, where from the high in 2015, there has been a shift in the demand schedule to the left in 2017, which is still an excess demand situation. Moreover, although data for the entire 2018 fiscal year are not yet available, the first two quarters of data from IIUSA show 4,469 I-526 submissions, down 27% from the same two quarters of 2017 when 6,126 submissions were received. Annualizing this amount by simply doubling it, although fraught with potential error, results in an estimated total for 2018 of 8,938. If these estimates closely approximate the actual 2018 visa data, I-526 submissions and visa demand are in a downward trajectory starting in 2015, implying more leftward shifts in the demand, which would again result in an excess supply situation at the current $500,000 level.

FIGURE 5:

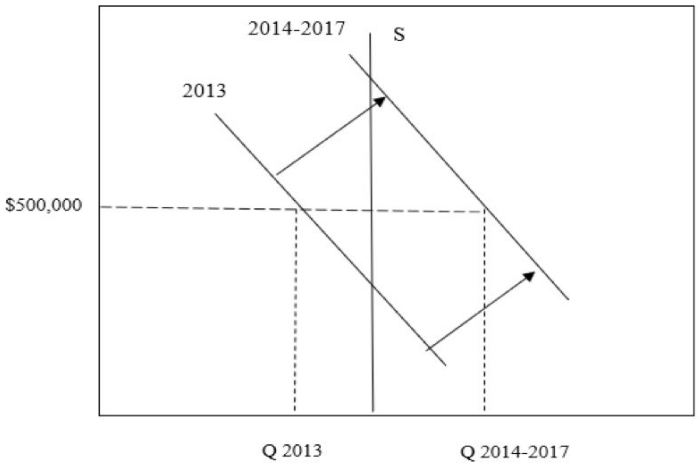
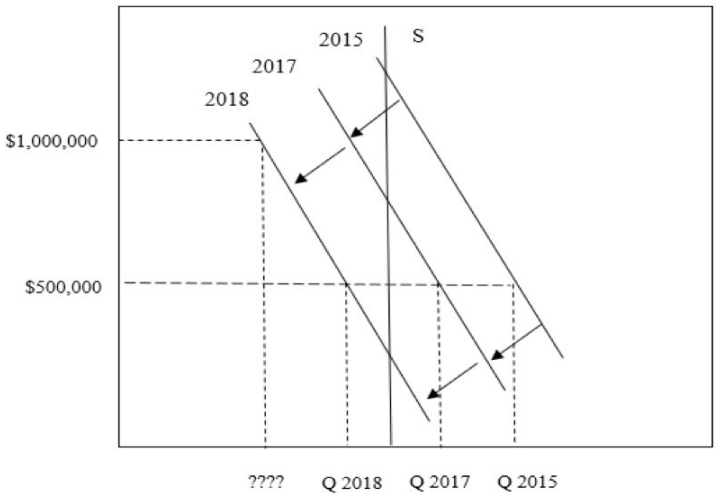


FIGURE 6:



What is the likely effect of investment price increases beyond current levels? Even if the demand for the EB-5 visa is more inelastic than I assume, the effects will be to diminish significantly the quantity demanded of the EB-5 visa. Due to the more stringent criteria proposed for the TEA investment level amounts, wherein few projects will qualify for lower levels, the effective investment amount in current proposals will likely be $900,000-$1,800,000, representing a doubling or more of the current price. Price increases of this proportion will move the quantity demanded upward to the left along the 2018 demand curve, while at the same time this curve is shifting to the left due to retrogression. This situation is also illustrated in Figure 6 where the demand has fallen in 2018 while also faced with a new higher investment amount of $1,000,000 or more. As drawn in the diagram, the new total revenue box created from the difference in price from $500,000 to $1,000,000 is larger than that lost from the reduction in investors from Q 2018 to the new number that is currently unknown, showing that total revenues from EB-5 capital has in fact increased even with a much smaller number of investors. However, this increase in revenues is by no means a certain outcome. By contrast, if demand is more elastic than drawn there could be a much larger decrease in quantity demanded and total EB-5 capital could well decline. Either way, there will be a much smaller number of investors being processed, leading to less retrogression, and less administrative work for both USCIS and regional centers. While this is a positive effect, it also diminishes greatly the service provider income the industry has supported with larger numbers of investors.

Finally, what is the likely effect of the proposed alternative interpretation of the visa cap that would include only investors? One must conclude that retrogression effects would be reduced, and this would increase the demand for the EB-5 visa by Chinese investors, at least to some extent, even with higher investment amounts. Whether the reduction in quantity demanded from the higher investment amount would outweigh the increased demand for the visa, however, is an open question.

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